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THE QUEST FOR A NEW CORPORATE TAXATION MODEL AND FOR AN EFFECTIVE FIGHT AGAINST INTERNATIONAL TAX AVOIDANCE WITHIN THE EU

Dr. Luca Cerioni (*)

1. Introduction

In the backdrop of an increasing awareness about the inadequacy of the corporate taxation systems to the current economic reality of business activity and in particular of multinationals, and of the increasing concern to fight international tax avoidance, the Commission published the March 2015 Tax Transparency Package¹, the June 2015 Communication on “A Fair and Efficient Corporate Tax System in the European Union”², and the January 2016 “Anti-Tax Avoidance Package” (A.T.A.P.)³.

In particular, the Commission has been consistently stressing that companies should pay tax in the country where profits are generated, which would be the country where the activity takes place⁴, and has made it clear that its long-term objective lies in the adoption of a mandatory Common Consolidated Corporate Tax Base (CCCTB)⁵. In its view, this would be essential for achieving a fair, efficient and transparent corporate taxation system, and, once adopted, CCCTB would prevent aggressive tax planning in the EU⁶. However, pending the adoption of the CCCTB, the Commission has been proposing a number of measures for ensuring taxation where profits are generated, and, in this connection, for enhancing Member States’ abilities to tackle international tax avoidance.

Given that specific proposals submitted in the literature have been trying to offer inputs on how to achieve, in essence, the same objectives, three issues seem to arise: *whether* the Commission’s proposals appear to be more or less consistent with such objectives than the solutions suggested by literature; *whether* an additional far-reaching proposal could be elaborated to collect the inputs offered by literature and to facilitate the Commission’s long-term objective, how this proposal could be structured.

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¹ COM(2015)136final, Communication on tax transparency to fight tax evasion and avoidance, at p. 5

² COM(2015)302 final, A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action,

³ COM(2016)23/2, Anti-Tax Avoidance Package: Next Steps towards delivering effective taxation and greater tax transparency in the EU

⁴ COM(2015),302final, cit., at 2; COM(2016)23/2, at p. 2 and 4

⁵ COM(2015),302final, cit., at 7; COM(2016)23/2, at p. 8

⁶ Id.

This work intends addressing these issues, without any claim to exhaust them.

2. The Commission's intended actions and the proposals in the A.T.A.P.

In the June 2015 Communication, the Commission specified that the new corporate taxation approach needed in the EU, to achieve a fairer and more efficient taxation and to fight tax avoidance, would serve to: re-establish the link between taxation and where economic activity takes place; ensure that Member States can correctly value corporate activity in their jurisdiction; create a competitive and growth-friendly corporate tax environment for the EU; protect the single market and secure EU approach to external corporate tax issues, including measures to implement the OECD Action Plan on base erosion and profit shifting (BEPS) which has the purpose of tackling aggressive tax planning at a global level⁷.

To achieve all intended objectives, the Commission proposed change in the following five areas⁸: *a)* re-launching the common consolidated corporate tax base (CCCTB) project, for which a draft Directive was published in 2011⁹; *b)* ensuring effective taxation where profits are generated; *c)* achieving a better tax environment for businesses; *d)* ensuring tax transparency; *e)* strengthening EU tools for cooperation.

To *re-launch the CCCTB project*, a new proposal would make it mandatory – rather than optional – and would develop a staged approach to its implementation. This staged approach would firstly focus on securing a *common tax base*, and, only after the implementation of a common tax base, it would concentrate on consolidation. The common tax base, on its own, is expected to bring major benefits in comparison with the current situation: the elimination of mismatches between national systems, which are often exploited by aggressive tax planners; the elimination of the possibility of using preferential regimes for profit shifting; etc..

The Commission stated that a fully fledged CCCTB would make a major difference in strengthening the link between taxation and the place where profits are generated. However, it also argued that – pending the preparation of the new proposal – the work should continue on international aspects of the common tax base which are linked to the OECD's BEPS project, and which should be essential in ensuring effective taxation where profits are generated.

Consistently with these intentions, the January 2016 A.T.A.P. aimed at ensuring a coordinated implementation in Member States of BEPS measures, and in several

⁷ OECD (2013) Action Plan on Base Erosion and Profit Shifting, OECD Publications, p. 7-8

⁸ R.Veldhuizen, T. Adorjan, *EU Introduces Plans Regarding a Fair and Efficient Corporate Tax System*, European Taxation, vol. 55, No. 11, 2015, 523 - 527

⁹ Proposal for a Council Directive for a Common Consolidated Corporate Tax Base (CCCTB), COM (2011), 121/4.

respects, marked a follow-up of the initiatives set out in the 2015 Action Plan. The A.T.A.P. included: a proposal for a general Anti-Tax Avoidance Directive, aimed at introducing uniform measures to target typical aggressive tax planning strategies which directly affect the functioning of the internal market¹⁰; a Recommendation on the implementation of measures relating to permanent establishments (PE) and of the report on tax treaty abuse issued by the G20/OECD¹¹; a proposal for a Directive amending the Administrative Cooperation Directive to implement the “country-by-country reporting”(CbCR)¹², a Communication on an effective strategy toward third countries¹³, and a staff working document providing further analysis and support for these initiatives¹⁴.

The proposal for a general Anti-Tax Avoidance Directive, which was conceived to achieve a balance between a certain degree of uniformity in implementing the rules recommended in the BEPS plan across Member States and the need to accommodate the specific features of their tax systems within these new rules, is expected to create a level playing field of minimum protection for all Member States’ corporate tax systems¹⁵. For this purpose, this proposal would require Member States: to *limit the deduction of interest-expenses* in relation to intra-group borrowing¹⁶; to levy *exit taxes* with the option of deferred payment through at least five annual instalments¹⁷; to apply a *shift from the exemption method to the tax credit* method (“switch-over clause”) in case of income received by a resident taxpayer from an entity resident in a low-tax third country¹⁸; to set a *general anti-abuse rule* (G.A.A.R.), under which national tax authorities would ignore non-genuine arrangements (i.e., arrangements which are not implemented for valid commercial reasons) for the purpose of calculating the corporate tax liability¹⁹; to apply *CFC rules* to controlled subsidiaries in low-tax jurisdictions²⁰; to eliminate the cases of double non-taxation caused by *hybrid mismatches* (i.e., by differences between two legal systems in the characterisation of financial instruments or of entities)²¹. The proposed Anti-Tax Avoidance Directive constitutes therefore the most substantial component of the effort to *ensure effective taxation where profits are*

¹⁰ COM(2016)26 final, 28.1.2016, laying down rules against tax avoidance practices that directly affect the functioning of the internal market

¹¹ Commission Recommendation C (2016)271final, 28.1.2016, on the implementation of measures against tax treaty abuse.

¹² COM(2016), 25 final, 28.1.2016 amending Directive 2011/16 as regards mandatory automatic exchange of information in the field of taxation

¹³ COM(2016)24final, 28.1.2016, on an External Strategy for Effective Taxation.

¹⁴ COM(2016)23

¹⁵ COM(2016)26 final, cit., at 4

¹⁶ Id., Art. 4

¹⁷ Id., Art. 5

¹⁸ Id., Art. 6

¹⁹ Id., Art. 7

²⁰ Id., Art. 8 and 9

²¹ Id., Art. 10

generated, since its provisions would target the typical strategies through which companies (e.g., through tax residence transfers) and corporate groups (e.g., through inflated interests payments or through payments exceeding arms' length prices to subsidiaries in low-tax countries) could be able to shift profits to lower-tax jurisdictions.

The same ratio (of ensuring effective taxation where profits are generated) is shared by the Recommendation included in the A.T.A.P., which encourages Member States to implement the proposed new provisions of Art. 5 of the OECD Model as drawn up in the final report on Action 7 of the BEPS²². This implies that Member States should expand the definition of PE, to include “commissionaire arrangements” and to restrict the specific exceptions applicable to activities of preparatory or auxiliary nature.

With regard to ensuring *a better tax environment for business*, in the 2015 Action Plan the Commission highlighted its intention – pending the introduction of a full CCCTB consolidation - to propose the offsetting of profits and losses of corporate groups in different Member States, and stressed the need to improve double taxation dispute resolution mechanisms²³. In the A.T.A.P., these intentions were not expressly stated again, but the Commission, in the accompanying Communication, specified that the measures included in the A.T.A.P. have been designed so as “to minimize the risk of double taxation as much as possible”²⁴. Moreover, in draft Anti-Tax Avoidance Directive, it clarified that, should the proposed rules give rise to double taxation, taxpayers should receive relief through a deduction for foreign tax paid, so that those rules – in addition to countering tax avoidance practice – should also avoid creating obstacles to the market such as double taxation²⁵. Although the Commission has interchangeably used the wording “minimize” and “avoid” with respect to double taxation, it has therefore made it evident (again) that the elimination of double taxation²⁶ is as necessary as the fight against aggressive tax planning.

In the area of *tax transparency*, the 2015 Tax Transparency Package²⁷ already resulted in the introduction of Directive 2015/2376 which has amended the Administrative Cooperation Directive²⁸ through the extension of the automatic information exchange to advance “cross-border tax rulings” and “advance pricing

²² Commission Recommendation C(2016)271final, cit., Art. 3

²³ COM(2015)302final, cit., at p. 11-12.

²⁴ COM(2016)23/2, cit., at p. 8

²⁵ COM(2016) 26 final, cit, at p. 11

²⁶ Which was already indicated as an objective in the Communication COM(2011)712final, double taxation in the internal market.

²⁷ COM(2015)136final, Communication on tax transparency to fight tax evasion and avoidance, at p. 5

²⁸ Council Directive 2011/16/EU as regards administrative cooperation in the field of taxation, of 15 February 2011, OJ EU L 64/1 of 11.03.2011

agreements” (APAs) in the area of transfer pricing²⁹. These amendments were proposed on the assumption that it is other Member States which are best placed to assess the potential impact and relevance of such rulings, rather than the Member State giving the ruling³⁰. They are supposed to ensure greater openness and transparency between the tax authorities, and to help governments to better protect their tax bases. Directive 2015/2376 contains broad definitions of “advance cross-border rulings” and of APAs³¹. The former include rulings which concern the interpretation or application of a legal or administrative provisions relating to cross-border transactions, or to the question whether activities carried on in another jurisdiction create a PE. The latter include unilateral or bilateral or multilateral APAs and/or decisions, which indicate, in advance of a proposed transactions, an appropriate set of criteria for the determination of transfer pricing or determines the attribution of profits to a PE³².

Once the new definition of PE based on the final report for Action 7 of the BEPS were adopted, following the Commission’s Recommendation included in the A.T.A.P, the exchange of “advance cross-border rulings” concerning the existence of a PE would serve as a reciprocal *cross-checking*, as between Member States, of the conformity of their national rulings with this adjusted definition of PE.

In the A.T.A.P., the Commission carried forward two other tax transparency initiatives, that it had anticipated in the 2015 Action Plan: ensuring a more common approach towards third country non-cooperative tax jurisdictions, due to the worldwide scale of corporate tax avoidance, and introducing a CbCR in the EU.

On the one hand, the A.T.A.P. Communication on an external strategy for effective taxation³³ highlights the goal to achieve a common EU approach in assessing, screening and listing third countries, to identify those jurisdictions which do not comply with good tax governance and to make it possible a unified EU response to these jurisdictions (exchange of information is regarded as a key component of good tax governance). On the other hand, the introduction of a CbCR is being pursued, in the proposal for amending the Administrative Cooperation Directive³⁴, by requiring a mandatory automatic exchange of information on CbCR. Under this proposal, each Member State would require the resident ultimate parent company of a multinational

²⁹ Council Directive 2015/2376 of 8 December 2015, amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, in OJ EU L 332 of 18.12.2015.

³⁰ Communication COM(2015)135final, Proposal for a Council Directive amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation

³¹ Council Directive 2015/2376, cit., Art. 1(b).

³² Id.

³³ COM(2016)24final, cit.

³⁴ COM(2016)25final, cit.

group to file a CbCR, and, by means of automatic exchange, would communicate this report to any other Member State where, on the bases of the information on the report itself, the group has either subsidiaries or PEs³⁵. As the CbCR would contain information – in terms of revenues, profits before taxes, income tax paid and accrued, number of employees, stated capital, accumulated earnings, tangible assets or cash equivalent – concerning each jurisdiction in which a multinational groups operates³⁶, the information relating to extra-EU jurisdictions to be included in the CbCR could only be verified with the cooperation of the concerned extra-EU tax authorities. The external strategy for effective taxation and the introduction of a CbCR therefore turn out being complementary to each other.

A fifth area of action, in the 2015 Action Plan, would strengthen *EU tools for coordination*. The Commission anticipated a new proposal to extend the mandate of the Code of Good Conduct on Business Taxation³⁷, to allow it to react more efficiently to cases of “harmful tax competition”. It also announced its intention to promote greater cooperation between Member States as regards tax inspections and tax audits – which is provided for in the Administrative Cooperation Directive³⁸ – and, in this respect, to start a discussion within the Platform on Tax Good Governance³⁹. In the A.T.A.P., these two final intentions were not expressly repeated, though they are certainly compatible with the contents of the A.T.A.P. itself.

All short-term initiatives set out in the Action Plan - amongst which those carried forward in the A.T.A.P. - should be regarded as short-term measures supporting or facilitating the long-term introduction of the CCCTB⁴⁰. The Commission has, however, stated that the short-term measures, in essence, would have a merit on their own, as they “will contribute to achieving *revenue stability*, a *stronger Single Market*, greater *corporate resilience and efficiency* and a *fair and level-playing field* for businesses”⁴¹.

³⁵ Id. Art. 1(2).

³⁶ Id., Art. 1(3)

³⁷ EU Code of Conduct (1997), Conclusions of the ECOFIN Council meeting on 1 December 1997 concerning taxation policy, DOC 98/ C2/ 01, OJ C2 (1998)

³⁸ Council Directive 2011/16, cit., Art. 12

³⁹ I.e, the Commission Expert Group known as Platform for Good Tax Governance, Aggressive Tax Planning and Double Taxation, set up by Commission Decision of 23.4.2013, C(2013)2236Final.

⁴⁰ R.Veldhuizen, T. Adorjan, *EU Introduces Plans Regarding a Fair and Efficient Corporate Tax System*, European Taxation, cit., at 525-526.

⁴¹ COM(2015)302 final, A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action, cit., at 14.

These desired achievements can thus be taken as a benchmarks, against which the proposals of academic literature can also be assessed comparatively with the short-term measures proposed by the Commission.

3. The proposals by literature

Just as the Commission, academic literature has also been taking as a starting point that the existing corporate tax systems are no longer suitable to the current economic reality, but has been proposing different solutions. Three proposals, in particular, appear to suggest a radical departure from the current rules, and can be assessed against the objectives set out by the Commission.

3.1. The destination-based corporation tax (DBCT) proposal.

A first idea is a destination-based corporation tax (DBCT)⁴², according to which sales should becoming a connecting factor for tax jurisdiction⁴³. The DBCT idea takes sales destination as a place of relative immobility, due to customers being less mobile than business activities. Its proponents argued that, in a globalized economy - where capitals freely move from one country to another - the very fundamentals of the international tax system need to be re-examined by overcoming the distinction between residence and source, and by choosing a new connecting factor.

According to the DBCT proponents⁴⁴, the country where the customer is based, would be entitled to tax the company's profits essentially for three reasons: sales are the ultimate origin of profit, and without sales there would be no taxable income; it is the country of the "income-origin activity" and, as such, its entitlement to tax would stem even from the principle of territoriality under international law; as country where consumers are based, it provides services which indirectly contribute to the generation of income. The destination country would also be able to exercise enforcement jurisdiction, simply by delegating the collection of the tax to the country where goods are produced, which is supposed to be the residence country, through a "one-stop-shop" approach. The proponents argue that this second country could require the company to declare the destination of its outputs, and then collect the tax, by applying the destination country tax rate, and pass the revenue to the destination country itself: in

⁴² M. Devereux, R. de la FERIA, Designing and Implementing a destination-based corporation tax, WP 14/07, May 2014

⁴³ For similar earlier suggestions: R. Avi-Yonah, Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State, 2000 Harvard Law Review 113(7), 1573-1676, at 1670-1671; A. Auerbach, M. Devereux and H. Simpson, "Taxing Corporate Income" in J. Mirrlees et al (eds.), Dimensions of Tax Design: The Mirrlees Review (Oxford: Oxford University Press, 2010), 837-893; A. Auerbach and M. Devereux, "Consumption and Cash Flow Taxes in an International Setting" (2012) Oxford University Centre for Business Taxation Working Paper Series, WP 12/14.

⁴⁴ M. Devereux, R. de la FERIA, Designing and Implementing a destination-based corporation tax, cit., 13.

the end, the tax authorities of both country could do an aggregate reconciliation across all transactions in a given tax year⁴⁵. The collecting country would then be allowed to charge a fee for collection, which may be a small proportion of total revenue collected⁴⁶.

Undoubtedly, by linking the tax base to the market destination, the DBCT would manage to make the tax base inelastic and far more immovable than in the current legal order. This inelastic and immovable tax base would also manage to *stabilize* revenues, due to the overcoming of the problem of “profit shifting”, and to create a *fair and level playing field* throughout the EU, due to the irrelevance of the place of residence and, consequently, the irrelevance of the corporate tax rate in that jurisdiction.

The DBCT suggestion - due to its very being based on a stable sales-destination connecting factor - instead of the place where the activity is carried on, would also eliminate the scope for the wider definition of PE recommended by the Commission in the context of the A.T.A.P.⁴⁷, for the implementation of the OECD transfer pricing guidelines, which the Commission, as stated in a communication accompanying the A.T.A.P., wishes to ensure⁴⁸, and for most of the measures indicated in the proposed Anti-Avoidance Tax Directive⁴⁹ too. Specifically, with regard to the provisions of the proposed Anti-Avoidance Tax Directive, only the limitation of deduction of interests on intra-group borrowing⁵⁰, and the anti-hybrid mismatch arrangement provision⁵¹, would make sense. This because a group company selling in a high-tax jurisdiction (and subject to tax there) could still - without a rule limiting interests deduction - reduce the tax base, in this jurisdiction, through excessive interest payments to another group company having its market base in a low-tax jurisdiction. Moreover, an intergroup payment made by a company having its market in a high tax jurisdiction to another company having its market in a lower tax-jurisdiction, and which were deductible in the first jurisdiction but exempt in the second one, would still lead to double non-taxation.

None of the other conducts targeted by the proposed Anti-Avoidance Directive would manage any more to shift the tax base once – in a DBCT regime – the allocation of the tax base were completely *unrelated* to the residence or to the location of a PE. Exit taxation, switch-over clause, CFC rules, and the GAAR, would thus lose their

⁴⁵ Id., 20

⁴⁶ Id., 21

⁴⁷ C(2016)271final, cit., Art. 3

⁴⁸ COM(2016) 23/2, cit., at 5

⁴⁹ COM(2016)26final, cit.; retro, par. 2

⁵⁰ Id., Art. 4

⁵¹ Id., Art. 10

scope. The introduction of a measure to allow the cross-border losses offsetting would also become meaningless, due to the very adoption of an exclusive sales-destination based tax base. The exclusive taxing nexus with the sales destination country would also eliminate any scope for an automatic exchange of information concerning APAs and “cross-border tax rulings”.

A CbCR would still find its scope, as it could assist national tax authorities of sales-destination countries in cross-checking the accuracy of sales figures and of taxable profits amounts. It would have to indicate, for each country, the amount of sales, the taxable profits, and the tax due. As the residence country would be, in the suggestion, the “enforcement jurisdiction”, the CbCR would still need to be transmitted to this country tax authority, which, in turn, would need to transmit it to each sales destination country tax authority.

In fact, in this proposal, the residence country, via the “one-stop-shop” mechanism, would still have a role in tax collection on behalf of the destination country. However, the DBCT proposal could end up charging a residence state A with the task of acting as tax collector for a destination country B – for any corporate taxpayer resident in State A and selling in country B – without a *reciprocity* condition. In fact, the possibility of reciprocity would be entirely outside the control of individual countries’ legislators and tax authorities, because it would end up depending only on market demands and thus on the presence of taxpayers resident in country B and selling in country A for comparable amounts leading to similar tax revenues. The fee for collection that would be charged by the residence country should at least cover the costs incurred by its tax authority for the collection itself, but could certainly not lead to reciprocity.

Without reciprocity, in the event of dual tax residency under the domestic laws of country A and of country B⁵², the allocation of tax residence would not bring revenue advantages to any of the two countries (tax residence being not a connecting factor for tax jurisdiction). Therefore, neither of the two countries would be particularly keen in being allocated the tax residence, and the “one-stop-shop” mechanism based on collection of revenues by the residence country on behalf of the destination sales country might not (necessarily) work.

Lastly, in a DBCT regime, a common strategy towards non-cooperative third countries would also still make sense: as companies based in third countries but having

⁵² A situation where the new Art. 4(3) of the OECD Model - as resulting from the changes indicated by the Final Report on Action 6 of the BEPS - will require the two tax authorities to *try* to reach an agreement: OECD, Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6: 2015 Final Report, p. 72.

their market base within the EU would be taxable by the Member States where they sell their goods or services, and vice-versa, cooperation in the form of information exchange with third countries would be essential.

3.2. *The proposal for a “Corporate Tax 2.0”*

Another academic proposal, which its Author considers a proposal for a “Corporate Tax 2.0.”, aims at suggesting - for taxing multinationals in the global market – a new corporate tax system that should be based, within each state, on the concepts of equal treatment for taxpayers in the same economic circumstances, irrespective of residence⁵³. The proposal argues that all economic operators with an economic presence (“nexus”) within the relevant taxing jurisdiction should be taxed on their worldwide business income, with a tax relief equal to the amount of the domestic tax attributable to the foreign income. According to the proposal, the “single tax principle” should be followed, to avoid both double taxation and double non-taxation, and the relevant taxing jurisdiction would be the geographical source most closely aligned with the income earned. In this suggestion, the taxable base should consist of the “economic rent”, i.e. of the investment returns in excess of the normal returns on the production investments, and this taxable base should be determined by granting a deduction for equity financing.

As regards the taxable base, this proposal – just as the DBCT suggestion - would aim at allocating the taxing nexus to the countries where the multinational’s products or services would be effectively sold. The “taxing nexus” would be allocated to the market jurisdictions where sales exceed a quantitative turnover threshold. The taxable unit would be the group as a multinational enterprise, and the ultimate parent company would act as “principal taxpayer” for corporate tax assessment purposes toward her taxing jurisdiction, and would receive the tax assessment.

This proposal would have, in common with the CCCTB, the “one-stop-shop” approach and the existence of a “principal taxpayer”, but – unlike the CCCTB, and similarly to the DBCT – would *completely* overcome the current international tax framework based on “residence” and “source”, on the “PE”, etc.. Undoubtedly, even this proposal - just as the DBCT – would manage to make the tax base inelastic, by linking the tax base to the market destination, and far more immovable than in the current legal order. All the advantages that the DBCT would bring in terms of

⁵³ M. de Wilde, ‘Sharing the Pie’: Taxing Multinationals in a Global Market, in 43 Intertax, vol. 6 and 7, 2015, 438-446.

stabilization of tax revenues, would obviously be generated by the “corporate tax 2.0” proposal as well.

On the other hand, unlike in the DBCT suggestion, in this proposal – due to taxation being subject to sales exceeding a certain turnover - there would be the risk of no taxation at all in case of profits below this turnover. This would be consistent with the idea of taxing only “economic rents”, i.e. the parts exceeding a normal rate of return. However, assuming that this proposal were to be considered within the EU, a choice of taxing only “economic rents”, and the related risk of no taxation at all for the part of the profits below the taxing threshold, would be difficult to reconcile with the Commission’s stated objective to avoid double non-taxation⁵⁴. Moreover, this choice would give rise to the question as to whether – to avoid the setting of excessively different normal rate of returns by the different Member States – an EU legislative measure should harmonize the determination of the “normal rate of returns” (and thus, indirectly, the determination of economic rents), e.g., by setting a range between minimum and maximum rates to be applied to different economic sectors.

It would seem, in fact, appropriate to avoid large differences between one country and another in the determination of the taxing thresholds, particularly if the level of “economic rents” were to depend on an harmonized level of normal rate of returns. In fact, because taxation would only concern the “economic rents”, excessive disparities in the taxing thresholds would, in some countries setting the lowest taxing thresholds, risk resulting in a taxation of “normal returns” that the proposals aims at avoiding.

For profits exceeding the taxing threshold, the risk of double non-taxation would be eliminated, but the “one-stop-shop” system would be difficult to implement, and so would be the role of “principal taxpayer” by the ultimate parent company, because it would be necessary, in each jurisdiction, to report the worldwide profit and then to apply the tax relief for foreign profit. This proposal would not seem, for this reason, to be able to achieve one of the objectives that drove the Commission to pursue the CCCTB: the administrative simplification of cross-border corporate tax compliance.

However, the “corporate tax 2.0” suggestion could be revised to maintain its current strengths, and, at the same time, to eliminate the risk of no taxation. For this last purpose, it would be sufficient to suggest the taxation, in each country where the group sells its product or services, only of the share of the overall profits arising from sales in that country through a *territorial taxation* system, instead of a worldwide taxation coupled with foreign tax credit. This would really lead to a “fractional taxation”, and

⁵⁴ Stated by the Commission in several occasions, including in the Explanatory Memorandum of COM(2016) 26 final, 2016/0011, at p. 3

– as the system would not be based on a worldwide taxation - it would require no tax credit for foreign profits. That would also make the suggestion effective from the perspective of achieving administrative simplification in tax compliance.

In any case, the implementation of the “corporate tax 2.0” proposal would obviously require, on a yearly bases, an automatic exchange of information concerning sales of each group (and of each company belonging to each group) in each EU country, and it would be necessary to establish whether the information flow should go from the country where most of the sales are directed to all other destination-based taxing jurisdictions.

Amongst the short term initiatives proposed by the Commission⁵⁵, the “corporate tax 2.0” proposal would make it purposeless the adjustment of the definition of PE and the same provisions of the Anti-Avoidance Tax Directive that would be made purposeless by the DBCT⁵⁶. The introduction of a measure to allow the cross-border losses offsetting, would lose their scope, due to the very adoption of a sales-destination based tax base. Again, this tax base allocation would also imply that transfer pricing issues would no longer arise, and that the automatic exchange of information on transfer pricing rulings would also lose its scope.

The Commission’s intention about ensuring transparency and strengthening cooperation between tax authorities would still make sense, but it would have to refer to the sales of each group in each country within the EU. This would be consistent, on the other hand, with the intention to require further information from multinationals, including a CbCR. Arguably, the CbCR would have to be submitted by the parent company – in a “corporate tax 2.0” scenario – not to its residence country (unlike in a DBCT scenario), but to its market-based main taxing jurisdiction, and would have to be sent by this jurisdiction to all other jurisdictions where the parent company itself, and other group units, sell their products and/or services.

Lastly, if the “corporate tax 2.0” were implemented, the concern, expressed by the Commission, to ensure that there is a link between tax benefits and the activities which they are intended to encourage (such as “patent boxes” for R&D activities) would still make sense, provided the tax benefits were granted – for the “economic rents” - by the market jurisdiction (as this would be the origin of profits).

⁵⁵ See retro, par. 2

⁵⁶ Retro, 3.1.

3.3. The NCCTB proposal

A further academic proposal consists of a “new common corporate tax base” (NCCTB)⁵⁷, which distinguishes again between *normal rate of returns* and *residual profits*, on the assumption that it has been much easier for Governments and tax authorities to tax routine profits of multinationals than to tax residual profits⁵⁸. The proponent suggests that the taxation of corporate profits should take place at two levels: at *national level* for the profits that correspond to a normal rate of returns on the investments made by the enterprise and its shareholders (which would represent a return on routine functions); at *EU level*, for the residual profit which cannot be easily linked to the functions carried out within a multinational enterprise or easily allocated to different jurisdictions, i.e. for profits such as those deriving from the creation, management and exploitation of intellectual property.

The NCCTB idea refers to the taxation of profits corresponding to the normal rate of return, and the tax base would be determined by only applying a cost-plus approach. This because low-risk or routine functions are typically remunerated on the bases of the arms’ length profit, which is based either on the cost-plus method (CP) or on a relatively small spread on the taxpayer’s individual turnover⁵⁹.

Several reasons were indicated for using a harmonized CP tax base: the application by all Member States of a CP approach in determining the tax base would avoid the risk of double taxation on profits deriving from routine functions within the EU; a company’s *cost base* is much more difficult to manipulate than a company’s turnover and is a measure of the *economic presence* of a company in a jurisdiction; it would be far less complex as a system than the current ones and would provide advanced certainty; it would result in acceptable effective tax rates; it would be difficult to avoid, and Member States would remain free to apply their preferred amount of markup and of corporate tax rates. The cost base – to be used for determining the NCCTB – would exclude costs items such as interest expenses and intercompany payments, which, in the current systems, give rise to base erosion and profit shifting, and to transfer pricing issues. The NCCTB would thus focus only on external expenses, i.e. on direct and indirect expenses, i.e. on operating expenses, general, legal and administrative expenses, paid to third parties, irrespective of whether these expenses, borne by a group company in a Member State, should economically be allocated in whole or in part to another group company in another Member State.

⁵⁷ See J.W. Bellingwout, *Blueprint for a New Common Consolidated Corporate Tax Base*, European Taxation, 1/2015

⁵⁸ *Id.*, at 4.

⁵⁹ *Id.*, at 7.

It was argued that a NCCTB along these lines would eliminate all issues which were indicated in the BEPS Action Plan⁶⁰, and that the application of the NCCTB would be easier than the application of the CCCTB, because the NCCTB would not need an apportionment formula given that the cost base of the NCCTB, free from intercompany expenses, is a formula in itself. Specifically, in case of multinational groups with subsidiaries and branches in more Member States, the taxpayer would be identified, in each Member State, by aggregating all the cost bases of all group companies resident in a given Member State and local branches of non-resident companies. All these group units would become a *single aggregate* corporate taxpayer (on behalf of the multinational enterprise) toward that Member State, and one of the companies resident in that Member State would file the aggregate corporate tax return – based on the CP method – on behalf of all of them. There would thus be a “one-stop-shop” approach within any single Member State for the fulfillment of tax obligation of the (aggregate) taxpayer operating in its jurisdiction, and not – unlike the CCCTB – a “one-stop-shop” for the entire group in the Member State of residence of the parent company.

Even more importantly, due to the CP tax base and to the aggregation of tax base for each country where the multinational group operates, there would be neither cross-border consolidation nor apportionment. Each Member State would have a positive corporate tax base due to the very determination of the NCCTB and to the identification of the taxpayer; the proponent highlight that this would avoid the issue of intra-EU cross-border losses and of distortions between purely domestic activities and EU cross-border activities.

3.4. The NCCTB proposal vs. the CCCTB and vs. the shorter-term initiatives proposed by the Commission

If the NCCTB proposal is compared with the Commission’s idea for a staged implementation of a mandatory CCCTB – started with a common tax base - and with the other Commission’s proposals, the NCCTB suggestion shows specific advantages and a potential disadvantage.

Firstly, the NCCTB – thanks to its cost base whose geographical location would be much more immobile than that of the current profit-based tax bases – would lead to *greater revenue stability* than the measures proposed in the 2015 Action Plan, and in the A.T.A.P., which are based on the current international tax framework and which therefore still assume a profit-based tax base. The NCCTB’s possibility of resulting in

⁶⁰ Id.

a fair and level playing field for businesses would inevitably depend on each business sector, accordingly to whether the differences in cost bases would be greater or smaller from one Member State to another. However, even in case of considerable differences in the cost bases, those differences could be partly neutralized if Member States agreed to coordinate with each other in applying mark-up measures that were inversely proportional to the cost bases. This coordination would lead - due to the CP method – to similar tax bases, and, ultimately, to a level playing field at least as far as the tax bases were concerned. This outcome would be comparable to that of a common tax base, but the NCCCTB - due to its eliminating the risk of profits shifting and of transfer pricing adjustments, even without the need for a cross-border consolidation - would certainly be far more effective than a common tax base, and, unlike the CCCTB, it could be implemented in one single stage.

The greater effectiveness of the NCCTB than a common tax base would derive from the fact that the *common tax base*, without the consolidation, would still need to rely on the arm's length principle (separate enterprises): thus, it would not manage to avoid the profit shifting issues and the transfer pricing disputes which the application of this principle has been generating up to present. On the other hand, a common tax base – by leaving unaltered the competition on tax rates – would make more transparent the differences between the effective tax burden deriving from differences in the nominal tax rates, and would thus risk even encouraging profits shifting to the lower-tax jurisdictions. This would paradoxically risk occurring at the same time as the Commission acknowledges that differences in corporate taxation between countries are the driving force for corporate profits shifting⁶¹. The NCCTB – by leaving to national tax jurisdictions only the application of tax rates on normal profits – would have the merit of eliminating the tax competition (and with it the risk of profits shifting) as regards the *residual* profits (which latter, according to the proposal, should be subject to tax at EU level). The importance of this aspect can be easily appreciated by considering that, in recent years, the well-known cases of tax planning strategies within the EU involving major US multinationals – cases such as Starbucks, Google, Apple, Amazon, etc.. - typically saw, through intra-group licensing arrangements, the shifting of profits arising out of the exploitation of intellectual property rights to group subsidiaries resident in low tax or no tax jurisdictions. There was thus, in these cases, a shifting of “residual profits”, in the terminology of the NCCTB proposal. Had the NCCTB been applied within the EU, such cases would obviously have not occurred.

⁶¹ COM(2015)302 final, A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action, cit., 5

Secondly, the NCCTB – due to its determining a positive corporate tax base within any individual Member State where a multinational group operates⁶² – would require less effort than the strategy⁶³ consisting of a common tax base accompanied by a measure on cross-border loss relief. Nonetheless, the efficiency gain that the NCCTB would bring about in this respect may be offset by a loss from the viewpoint of fairness in taxation (another objective pursued by the Commission). Specifically, the Commission’s intention of introducing – in parallel with a common tax base – a measure to allow cross-border loss offsetting between parent companies and subsidiaries, as well as between head office and branches, considers that cross-border losses ultimately reduce the ability-to-pay tax of either the company (considered as a legal entity including head office and PE) or the group as an economic unity.

Conversely, in the NCCTB suggestion, at least as currently formulated, a situation where a company bears costs higher than the actual revenues - i.e. a situation where a company actually suffers a loss instead of a normal profit - does not seem to be taken into account. In turn, this could lead to the taxation of a (partially) overestimated profits in the hand of the “aggregate taxpayer”, a situation which would be at odd with the ability-to-pay principle and would also certainly not be consistent with the EU’s objective of pursuing the (economic) well-being of its people. This objective is stated in Art. 3(1) of the TFEU, and should be interpreted as requiring (cross-border) loss relief⁶⁴. The risk of taxing a partially fictitious profits could be avoided (in a new version of the proposal) simply by excluding, from the aggregation, the companies suffering an actual loss, and for which thus the application of the markup would end up determining a wholly fictitious profit.

If the NCCTB approach were to be followed, due to the transfer pricing problem being overcome altogether, the automatic exchange of information on APA⁶⁵ would no longer find its scope. The automatic exchange of “advance cross-border rulings” could still apply, as regards the exchange relating to rulings concerning the existence of a PE in another jurisdiction⁶⁶, *only if* this were made relevant for verifying the existence and the amount of costs incurred in that other jurisdiction, and therefore for determining the cost base of that other jurisdiction. Equally, the adjustment of the definition of PE suggested by the Commission in the Recommendation included in the A.T.A.P.⁶⁷ –

⁶² Retro, 3,3,

⁶³ COM(2015)302 final, A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action, cit., 7.

⁶⁴ V.R.Almendral, *An Ever-Distant Union: The Cross-Border Loss Relief Conundrum in the EU*, 38 *Intertax* 10 476-501, 495 (2010)

⁶⁵ Council Directive 2015/2376, Art. 1(b), 14.

⁶⁶ Id., Art. 1(b), 16.

⁶⁷ C(2016)271 final, cit., Art. 3

which would be intended to prevent artificial avoidance of the source country taxation – would still make sense only if the existence of a PE were made relevant in determining the cost base. In this case, the “advance cross-border rulings” to be exchanged under the amended Administrative Cooperation Directive⁶⁸, and relating to the existence of a PE, would all need to be *consistent with the adjusted definition* of PE, and consistent with each other.

None of the provisions that would be introduced by the proposed Anti-Avoidance Directive⁶⁹ should also apply. In fact, the CP base – by assuming the cost elements borne *in a given Member State* – would completely imply a territorial taxation system instead of a worldwide taxation system (and an entirely territorial taxation system would not leave scope for CFC rules and for switch-over clauses), and the markup from the CP, together with the exclusion of intra-group expenses, would leave no scope for interest limitation rules and for consideration of intra-group hybrid payments. Residence transfers would also become immaterial – and exit taxation would lose its scope – *if* the outgoing company still bears all costs in its original jurisdiction due to its business activity being still entirely carried out there⁷⁰ (e.g., through a branch).

On the contrary, the automatic exchange of information on CbCR⁷¹ would still be useful, for each national tax authority to be able to cross-check the tax returns submitted by each “aggregate taxpayer” and the information contained in the CbCR. However, the CbCR, unlike the one produced in the context of the current tax framework, would be unrelated to transfer pricing, and would need to be produced, for all the group, by assembling the information (in terms of normal profit and of tax paid) concerning each “aggregate taxpayer” (i.e, of the taxpayer resulting from the aggregation of all cost bases of group companies and local branches) in each country.

In the context of the NCCTB, it would also be possible to ensure and preserve the territorial link between preferential tax regimes, e.g. “patent boxes”, and underlying R&D economic activities that they are supposed to encourage, according to the “modified nexus approach” of which the Commission stated the intention to monitor the implementation by Member States⁷². It would be sufficient to apply, in any jurisdiction, either a reduced mark-up to costs incurred there in relation to the

⁶⁸ Retro, 2.

⁶⁹ COM(2016), 26 final, cit., Art. 8.

⁷⁰ A situation which, due to the lack of a genuine economic activity in the destination State, would not even be protected by the ECJ case-law on the freedom of establishment: *infra*, 4.1.

⁷¹ As required under the proposed Directive COM(2016)25final, cit., Art. 1

⁷² COM(2016) 23/2, cit., at 5

development of intellectual property or a reduced tax rate to the normal profit specifically derived from this activities.

Overall, the NCCTB suggestion – in its assuming a cost base with a markup for a “normal profit” – would certainly be attractive in term of simplicity, and, in being based on a “one-stop-shop” system in each country for the “aggregate taxpayer” carrying on activity in that country, it could also be effectively administered. Thanks to the one-stop-shop system, and the cost base, the NCCTB, by reducing the possibility of profit shifting, would also minimize the impact of differences in taxation (from one country to another) on taxpayers’ investments decisions.

As above argued, the NCCTB would make meaningless not only much of the actions indicated in the BEPS Action Plan, but also nearly all of the proposed initiatives set out by the Commission in its 2015 Action Plan and in the A.T.A.P., as it would offer an *alternative route to achieve the same objectives*.

4. The Commission’s intentions vs. the academic proposals: the scope for rethinking the fundamentals of the current international tax order

From the foregoing, it can be easily deduced that all three suggestions – due to the very connecting factors that they take, i.e. the costs (NCCTB) or the sales destination markets (“corporate tax 2.0” and DBCT) – would make meaningless, for corporate taxation purposes, the current Articles 4(3)⁷³, 5⁷⁴, 7⁷⁵ and 9⁷⁶ of DTCs based on the OECD Model.

Amongst the Commission’s intended five areas of work as laid down in the June 2015 Action Plan, the Commission’s intentions which would still find their scope are to bring taxation closer to the place where they are generated, and to improve tax transparency⁷⁷. The academic suggestions can also be considered from the viewpoint of their consistency with these intentions.

4.1. Bringing the taxation of profits closer to the place where profits are generated

⁷³ Dealing with corporate tax residence.

⁷⁴ Giving the definition of PE.

⁷⁵ Allocating taxing rights on business profits.

⁷⁶ Dealing with transfer pricing.

⁷⁷ Retro, 3.1., 3.2. and 3.4.

The Commission's intention to bring taxation of profits closer to the place where they are generated, is completely consistent with these academic suggestions: the only difference appears to lie in a *different conception about the place where profits are generated* and where, therefore, the taxable base should be allocated.

According to the Commission, profits are generated where the activity takes place⁷⁸, but *neither* the Action Plan *nor* the A.T.A.P indicate *where* a company is regarded as having its economic activity, i.e. the Commission has not expressly set out a specific test for establishing what are the indicators of economic activity being carried out in a given country.

Arguably, if and when the CCCTB comes into force, the apportionment formula based on labor, assets and sales⁷⁹ - if it were to be *maintained* as proposed in the first 2011 proposal⁸⁰ - would also suggest that the business activity is carried out, pro-quota, in all Member States where these factors exist. Nonetheless, given the Commission's intention to proceed with a staged implementation of the CCCTB starting from a common tax base without consolidation - and given the further possibility of amendments in the final CCCTB proposal - the 2011 version of the CCCTB proposal does not currently appear to be able to offer a definitive indication as to whether the criteria for identifying the location of the business activity will remain those suggested by the apportionment formula laid down at that time.

Indirectly, an indication about when a genuine economic activity takes place, would seem to emerge from the proposed Anti-Avoidance Directive⁸¹. This excludes the application of CFC rules to an entity which is tax resident in a Member State or in a third country belonging to the EEA or in respect of a PE of a third country entity in a Member State, unless the entity is wholly artificial, *or* unless the entity engages, in the course of its activity, in non-genuine arrangements having the essential purpose of obtaining a tax advantage⁸².

The first situation (wholly artificial entity) appears to be fully consistent with the ECJ's position in the 2006 *Cadbury Schweppes* ruling⁸³: here, the ECJ specified that, only if checking elements such as the physical existence of a subsidiary - in terms of premises, staff and equipment - leads to the finding that the subsidiary does not carry

⁷⁸ COM(2015)302 final, A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action, at p. 9; COM(2016). 23/2, cit., at p. 4

⁷⁹ Proposal for a Council Directive on the Common Consolidated Corporate Tax Base (CCCTB), COM(2011) 121/4, Art. 86

⁸⁰ *Id.*

⁸¹ COM(2016)26final, cit., Art. 8

⁸² *Id.*, Art. 8(2)

⁸³ Case C-196/04, *Cadbury Schweppes* [2006] I-07995

out any genuine economic activity in the territory of the host country, the creation of this subsidiary must be regarded as a wholly artificial arrangement⁸⁴ and the application of CFC rules by the state of residence of the parent company would be justified⁸⁵. The choice, in the proposed Anti-Avoidance Directive, to allow the application of CFC rules to the case of wholly artificial entities, suggests that, in the Commission's conception underlying the A.T.A.P., the place where a company is regarded as having its economic activity coincides with the concept of genuine economic activity emerging from this ECJ case-law.

However, the second situation (i.e. the case of an entity carrying out non-genuine arrangements) – given the definition of non-genuine arrangements⁸⁶ - would seem to contravene the ECJ's findings. In fact, the Commission, in defining the non-genuine arrangements, appears to have regard, ultimately, to the fact that the activities corresponding to the profits of the subsidiary could be directly carried out by the parent company⁸⁷. On the contrary, in *Cadbury Schweppes*, the ECJ clarified that such a situation would not warrant the conclusion that there is a wholly artificial arrangement⁸⁸. This part of the proposed Anti-Avoidance Tax Directive could therefore generate doubts as to whether the Commission intends *restricting* the concept of “place where the business activity is carried out” in comparison with the *Cadbury Schweppes* finding. Therefore, the lack - in the Action Plan and in the A.T.A.P. – of a precise definition of “place where the business activity is carried on”, would seem to leave uncertainty on this fundamental element of the overall Commission's strategy.

Moreover, the “place where the business activity is carried on” cannot be regarded as the top decision-making center, which, in essence, coincides with the “place of effective management” (POEM)⁸⁹. which has been serving as tie-breaker rule for tax residence under Art. 4(3) of DTCs based on the OECD Model⁹⁰.

The POEM criteria historically traces its origin from UK case-law developed since the end of the XIX century, under which the place where the *business activity is carried*

⁸⁴ Id, para. 66-68

⁸⁵ Id, para. 73

⁸⁶ COM(2016)26final, cit., Art. 8(2)

⁸⁷ Id.

⁸⁸ Case C-196/04, *Cadbury Schweppes*, cit., para. 69

⁸⁹ OECD Commentary to Art. 4 of the OECD Model, para. 24.

⁹⁰ Under the Final Report on Action 6 of the BEPS, POEM will be removed as a tie-breaker rule and turned it into *one of the criteria* to be considered when reaching mutual agreement for determining corporate tax residence: OECD, Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6: 2015 Final Report, p. 72. However, States that considers that the POEM can be interpreted in such a way to prevent abuse and agree on how to interpret it, will be able to continue to use it as a tie-breaker rule: id., p. 75

on is the place where the key decisions are taken⁹¹, i.e. where the “controlling brain” of the company is located⁹². If the “place where the business activity is carried on” were to be regarded as synonymous of POEM and if or when the POEM remains decisive in determining the tax residence⁹³, the concern expressed by the Commission (to re-establishing the link between taxation and where the economic activity takes place), would be meaningless, because, currently, the tax residence country always taxes a company due to the very existence of the residence connecting factor. Consequently, this concern makes sense whenever there is the risk of taxation being escaped in the country (different from the tax residence country) where profits originate.

It is significant, in this regard, that the broadening of the definition of PE, which would follow from the Recommendation included in the A.T.A.P.⁹⁴, would imply a broadening of taxing rights for the source country, and a corresponding restriction of the taxing rights of the residence country (which latter would have to give tax credit for a wider range of cases giving rise to a PE).

In addition, there is at least one situation where the current national tax residence in itself, as a connecting factor for corporate taxation, is arguably in contrast with the objective of rebuilding the link between taxation and the place where companies really make their profits, i.e. the place (according to the Commission) where economic activity takes place. This situation occurs when *no economic activity* takes place in the residence country as currently identified.

In this situation, whenever the tax residence country still applies the worldwide taxation principle, the tax liability in the residence country – although accompanied normally by the tax credit for tax paid in the source country – results in reporting and payment obligations in two countries, for tax relating to the same profits. Therefore, worldwide taxation may incentivize strategies to escape taxation in the source country, (to avoid the threshold of the taxable presence there, and thus to reduce the overall compliance costs), and the most effective route to pursue the objective stated by the Commission would be the allocation of *exclusive taxing rights* to the source country.

“Source” may be assumed to coincide – for the purpose of the Commission’s objective of rebuilding the link between taxation and where profits are *generated* -

⁹¹ E.g., case *De Bees Consolidated Mines Ltd v. Howe* (1906)5 STC 198: “A company resides, for the purposes of Income Tax, where its real business is carried on.....the real business is carried on where the central management and control actually abides”.

⁹² E.g., case *News Datacom Ltd and Another v. Atkinson* [2006] SpC 561

⁹³ Taking into account that, even after the changes to the OECD Model and Commentary that will follow from the Final Report on Action 6 of the BEPS (supra, n. 90), there may be cases where the POEM remains the key element.

⁹⁴ C(2016)271final, cit., at 4

with the “origin” of profits⁹⁵. Therefore, exclusive source taxation would be completely consistent with the academic proposals above discussed. It would have in common with the NCCTB proposal *both* the ultimate concern and the location of the activity as a connecting nexus (the NCCTB proposal would consider the activity to take place where the company incurs costs). It would have in common with the DBCT and with the “corporate tax 2.0” proposal only the concern the reconnect taxation with the place where profits are made, as these two last suggestions propose a connecting nexus that, due to its being linked to consumers demand, is expected, by its very nature, to be immovable or, at least, to be more stable than business activities.

Alternatively - in view of the stated objective – it would make sense to reformulate the concept of corporate tax residence, by accepting the idea, that was considered in a 2001 OECD discussion draft⁹⁶, of taking the “place where the economic nexus is strongest”⁹⁷ as a (new) criteria for tax residence. That discussion draft mentioned land, labor, capital and enterprise (the factors of production) used by the company in deriving its profits, and the idea of using these elements to determine to which State the company has the strongest ties to deem the company to be resident only in that State. As the country where the company uses its factors of production is also a country in which it incurs costs, that idea would be consistent with the NCCTB suggestion of taking costs as indicators of the economic presence of a company in a jurisdiction.

If the concept of tax residence were reformulated to reflect the place of the strongest economic nexus, a dual adjustment to the current definition of PE would also be appropriate.

The range of cases giving rise to a PE could certainly be broadened (as indicated by the Commission Recommendation included in the A.T.A.P.)⁹⁸ to situations – such “commissionaire arrangements” – where the economic activity is carried out in forms which are different from the examples listed in Art. 5(1) of the OECD Model and from the “agency PE” in Art. 5(5), but which show a clear link with the territory of the concerned jurisdiction. Nonetheless, the definition itself of PE as a fixed place of business as it currently reads under Art. 5(1) – which refers to “*wholly or partly* of the activity of an enterprise” - would need to be restricted only to a *part* of the activity. In

⁹⁵ Conceptually, a distinction could be drawn between “source” and “origin”: E.Kemmeren, Source of Income in Globalizing Economies: Overview of Issues and Plea for an Origin-Based Approach: 60 Bulletin for International Taxation 11, 2006, at 430-52. However, in this work, in light of the Commission’s wording referring to where profits are *generated*, it is assumed that “source” and “origin” can be used interchangeably.

⁹⁶ OECD, 2001, The impact of the communications revolution on the application of “place of effective management” as a tie-breaker rule.

⁹⁷ Id., p. 11-12

⁹⁸ Commission Recommendation C(2016)271 final, cit., Art. 3

fact, if the *whole* of the business activity was carried out in a country, that country could no longer be a country of location of a PE, having a *concurrent* taxing right, but it would need to become the jurisdiction having the *exclusive* connecting factor for taxation (i.e., the reformulated residence connecting factor, which, however, would no longer be different from the source connecting factor).

Overall, the DBCT idea, the “corporate tax 2.0” suggestion and the NCCTB suggestion – in addition to being all completely in line with the Commission’s intention to safeguard the taxing right of the source country – offer a *precise response* to the issue as to where the ultimate origin of profits can be located. In so doing, in essence all of them suggest connecting factors which, due to their very nature, would logically lead to *exclusive* taxing rights, and may thus offer the occasion, for the Commission, to consider again: whether the *ultimate originator* of business profits can be identified in the production *or* in the sale of goods or services; whether the tax base most *immune* to the risk of profit shifting (that the Commission wishes to avoid) should be based on the destination market *or* on the location of the activity, and, in this last case, whether a *cost base* (as in the NCCTB) would be the most reliable and immovable indicator.

Arguably, taking the *cost* base as the most reliable indicator of the carrying out of the business activity in a given jurisdiction, and of the origin of profits there, would be consistent with the ECJ’s indication, in *Cadbury Schweppes*, of the presence of premises, staff and equipment as elements proving a genuine economic activity⁹⁹, to the extent that the *investments* in premises, staff and equipment have been made in the jurisdiction at stake.

On the other hand, taking the market base as the origin of profits would not contradict this ECJ’s *Cadbury Schweppes* finding as an indication of a genuine exercise of the freedom of establishment, but would simply eliminate the scope for tax planning strategies consisting of transferring the tax residence – as *currently* identified - to low-tax jurisdictions, even where this transfer is protected by the freedom of establishment due to a genuine economic activity in the destination State¹⁰⁰.

The Commission - consistently with its highlighting that tax residence transfers distort the market by eroding the tax base of the State of departure and shifting future profits to be taxed in the low-tax jurisdiction of destination¹⁰¹ - in the draft anti-tax

⁹⁹ Case C-196/04, *Cadbury Schweppes*, cit., para. 54

¹⁰⁰ Id. and Case C-378/10, *VALE Epitesi*, [2012] ECR I-440, para. 34

¹⁰¹ COM(2016)26final, cit., at p. 7

avoidance Directive proposed the introduction of exit taxes¹⁰², among other measures intended to protect domestic corporate tax bases.

It was indeed suggested that multinational companies should be taxed in their residence country and that their ability to move should be restricted by using corporate exit taxation, on the ground that 90% of multinationals are currently headquartered in G20 countries, and that none of these countries have a corporate tax rate below 20%, so that what would be required (to protect the tax base) would be a coordination only between some 20 jurisdictions¹⁰³. Nonetheless, this suggestion would not seem to consider that, within the EU, corporate tax rates range from 10% to over 33%, and Member States not belonging to the G20 group¹⁰⁴ have proven to be a very attractive location for multinationals to be tax resident there.

Moreover, the Commission itself had to take into account that a tax residence transfer within the EU, or toward a EEA country, would be protected by the freedom of establishment ex Arts. 49 and 54 T.F.E.U under the ECJ case-law¹⁰⁵. For this reason, consistently with the ECJ case-law, the proposed exit taxation would allow outgoing taxpayer to defer the payment of the amount of the tax over at least five years¹⁰⁶.

Consequently, the *higher the difference* in the effective corporate tax rate between the country of departure and the country of destination, the *less effective* exit taxes (to be paid in instalments over at least 5 years) would be in discouraging such a tax residence transfer, even when the market base remains in the State of departure.

Taking the market base as an indicator of the ultimate origin of the profits would, therefore, be far more effective than exit taxes in protecting the corporate tax base of this State. Obviously, a market-based allocation of tax jurisdiction would also make completely useless for individual countries to compete with each other for attracting companies even through those special regimes that were politically banned by the Code of Good Conduct on Business Taxation, and would thus make it no longer necessary the (extension of) the mandate of this Code, that the Commission intends proposing¹⁰⁷.

4.2. Improving tax transparency

¹⁰² Id., Art. 5.

¹⁰³ R.S. Avi-Yonah, The International Tax Regime: A Centennial Reconsideration, Public Law and Legal Theory Research Paper Series, Paper No. 462, June 2015

¹⁰⁴ Such as Ireland.

¹⁰⁵ COM(2016)26final, cit., at p. 8

¹⁰⁶ Id., at p. 8 and p. 17. This would be necessary for consistency with the ECJ's ruling in Case C-371/10, *National Grid Indus* [2011] ECR I-12273

¹⁰⁷ Retro, par. 2

As already mentioned, if the academic proposals were to be taken forward, there would still need to be exchange of information as regards tax authorities¹⁰⁸.

In the Commission's proposal for a Directive amending the Administrative Cooperation Directive, tax residence plays a key role in the direction of information that should be automatically exchanged¹⁰⁹, but the proposal does not contain a definition of corporate tax residence. Neither is such a definition included in the proposed Anti-Avoidance Directive, although this hugely relies on the tax residence concept, e.g. in providing for exit taxes on the transfer of the tax residence and in setting CFC rules¹¹⁰. Seemingly, the Commission took it for granted that corporate tax residence could be *always* determined, by relying on the definition of tax residence under national laws¹¹¹ and under double tax conventions (DTCs) based on the OECD Model.

Nevertheless, literature has been highlighting the difficulty in determining corporate tax residence. Whereas formalistic rules such as the place of incorporation are vulnerable to manipulation in both traditional and electronic commerce environments, other rules such as the "place of central management and control" and the POEM test risk being ineffective in a computerized environment¹¹² (where top management functions can well be decentralized through electronic communication means). Even after the changes to Art. 4(3) of the OECD Model and to the Commentary that will follow from the Final Report on Action 6 of the BEPS plan¹¹³, this issue might remain. In fact, on the one hand the agreement that the tax authorities shall *endeavor* to reach on the tax residence should still take into account the POEM and the place of registration¹¹⁴, and on the other hand States wishing to continue using the POEM as a tie-breaker rule could still do so¹¹⁵. The new provision, whereby without an agreement between the two tax authorities on the determination of the tax residence the concerned company is not entitled to any relief or exemption provided under the DTC¹¹⁶, may certainly increase the interest of a dual resident company for the solution of the tax residence conflict, but it *does not guarantee the solution* if the mutual agreement

¹⁰⁸ Retro, 3.1., 3.2. and 3.4.

¹⁰⁹ COM(2016)25 final, cit., Art. 1 (2), and retro, par. 2

¹¹⁰ COM(2016)26 final, cit., Art. 5 and Art. 8

¹¹¹ Just as provided for by the Parent-Subsidiary Directive (Directive 2011/96/EU, Art. 2(a)(ii)), by the Merger Directive (Directive 2000/133/EC, Art. 3(b)), and by the Interest-royalties Directive (Directive 2003/49, Art. 3(a)(ii))

¹¹² D. Pinto, Exclusive source or residence-based taxation-is a new and simpler world tax order possible? Bulletin for International Taxation 61 (2007), 277-291, at 281.

¹¹³ See 90.

¹¹⁴ OECD, Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6: 2015 Final Report, p. 72.

¹¹⁵ Id., p. 75

¹¹⁶ Id., p. 72

procedure (MAP) in the DTC at stake does not contain a mandatory arbitration clause. Therefore, the risk of unresolved tax residence conflict is not bound to disappear.

In a situation of unresolved tax residence conflict, it would become virtually impossible to apply the provisions on automatic information exchange, including the provisions proposed by the Commission in its draft Directive requiring the exchange on CbCR¹¹⁷ (as well as the provisions proposed in its draft Anti-Avoidance Directive¹¹⁸). In fact, unless the tax residence conflict is resolved *before* the scheduled timing for the automatic exchange of information, each of the concerned country – in light of its internal legislation – might consider itself as entitled to receive the CbCR from the parent company and to transmit it to other national tax authorities, rather than being entitled to receive it from another national tax authority.

In the case of a CbCR that – by assumption – were to be applied in a “corporate tax 2.0” regime, the problem concerning difficulties in identifying the tax residence would not arise, as the country entitled to receive and transmit the CbCR could be the country where most of the sales of this company are directed if the parent company is not a pure holding, or, otherwise, it could be the country where most of the overall sales of other groups’ subsidiaries are directed¹¹⁹. Because the amount of sales destination per country would be a merely *quantitative* factor, it could in all cases be easily ascertained *before* the automatic transmission of information. This latter, therefore, could always take place (without the risk of tax residence conflicts hindering it).

Even from the viewpoint of tax transparency and of its effectiveness, the academic proposals would thus suggest a rethinking of a fundamental of the current international tax law order, such as the tax residence.

5. Another possible comprehensive solution (complementary to the CCCTB) for achieving a fair and efficient corporate tax system in the EU

The concepts of “fairness” and “efficiency” in taxation – which the Commission recalled in its 2015 Action Plan – are certainly not new, since, in essence, they trace back to well-known “Principles of taxation”¹²⁰: *equity*, whereby taxpayers should pay tax to the jurisdiction which allows them to earn their income; *neutrality*, whereby

¹¹⁷ COM(2016)25 final, cit., Art. 1 (2)

¹¹⁸ COM(2016)26final, cit., Art. 5 and Art. 8

¹¹⁹ Retro, 3, 3.2.

¹²⁰ Which, in their essence, were elaborated ever since 1776 by A.Smith in its landmark “Wealth of nations”, Book V, Chapter 2.

taxes should not influence economic decisions; *certainty*, whereby the time, the manner and the amount of payment ought to be clear to the taxpayer, *convenience*, whereby every tax (thus, including corporation tax) should be levied in a way which is most convenient for the contributor to pay it.

As regards the *equity* perspective, if the contribution of a given jurisdiction to the *generation of profits* is the criteria for allocation of taxing rights, it follows that only jurisdictions where profits are generated should have taxing rights. It was already argued by academic Authors that considerations of equity and efficiency, as a rule, support *exclusive* taxation in the source country¹²¹. The implication of the equity principle – in line, ultimately, with all academic suggestions above considered - would thus be: exclusive taxing rights should belong to the source countries, in proportion to the fraction of the overall companies' profits arising within each of their jurisdictions.

Each source country could take into consideration the overall company's ability-to-pay – i.e., take into consideration also the profits gained or the losses suffered in other Member States – through the *tax rates*, without including foreign profits in its tax base and without deducting foreign losses. Losses incurred in other Member States could therefore be taken into consideration by simply reducing the tax rates on profits gained in the concerned jurisdiction. The scenario here suggested could become feasible in light of the fact that, over the last decade, some countries have been switching from worldwide taxation to territorial corporate taxation for companies that they consider their own tax residents. Once the tax residence countries start giving up worldwide taxation and switching to territorial taxation, the distinction between residence taxation and source taxation starts disappearing anyway.

Neutrality – and thus the lack of influence on economic decisions within the single market, which was already advocated in 1992 by the Ruding Report¹²² - can, in turn, be achieved if the differences in corporate taxation regimes can no longer induce tax planning strategies and profit shifting. Again, this is possible to a higher extent, the higher the extent to which: on the one hand, the taxable base is *immovable* from the jurisdiction in which profit originates; on the other hand, there is an incentive for national legislators to *converge* toward each other's regime. Accordingly, even from the viewpoint of neutrality, giving exclusive taxing rights to the jurisdictions where profits originate, and from which they would be most inseparable, would be the most effective choice.

¹²¹ K. Vogel, Worldwide vs. source taxation of income – A review and re-evaluation of arguments, Intertax, No. 8/9, 1988,

¹²² Report of the Committee of Independent Experts on business taxation (Ruding Report), SEC(92) 1118.

Certainty would surely be fostered by the Commission's initiatives aimed at strengthening the cooperation between tax authorities¹²³, because only this co-operation can offer (to any taxpayers receiving cross-border incomes) legal certainty as regards their reporting and payment obligations towards all concerned countries. In this respect, the CCCTB project would go beyond the current level of administrative co-operation, as it would work through a central database in which all information would be stored and immediately accessible¹²⁴ and would thus result in *multilateral sharing of information*. This latter would be more effective than bilateral automatic transmission of information, given that it would allow tax authorities simultaneous access to information and would thus allow them an earlier settlement of any potential dispute, to the benefit of certainty for the concerned taxpayers.

Convenience – if read in respect of the fulfillment of cross-border tax obligations towards two or more jurisdictions - would be facilitated, undoubtedly, by the existence of a “one-stop-shop”, which would avoid the need for the concerned taxpayers to deal with several different national tax administrations. The one-stop shop is in the CCCTB proposal and is also in the academic suggestions above considered. However, in the CCCTB proposal, it would be for the tax authority of the residence Member State of the parent company, i.e. for the principal tax authority (PTA), to act as a one-stop-shop for the fulfillment of all group's tax related obligations; tax authorities of resident states of other group companies, if in disagreement with decisions of the PTA, should appeal before a court of the Member State of the PTA and enjoy at least the same rights as taxpayers of this State¹²⁵.

Given the difference on procedural rights standards between Member States, the possible lack of reciprocity in the treatment of the plaintiff tax authorities may risk creating tensions between the different national tax authorities, in addition to the difficulties that may arise for the very working of the scheme in case of tax residence conflicts concerning the parent company and of difficulties in locating its POEM. This because the very CCCTB scheme, if it were made compulsory under the current proposal, would still need to rely on the POEM¹²⁶ to identify the country of residence of the “principal taxpayer” in situations of dual tax residence.

Ultimately, in light of the foregoing, an optimal solution would need to ensure:

¹²³ Retro, par. 2

¹²⁴ Proposal for a Council Directive on the Common Consolidated Corporate Tax Base (CCCTB), COM(2011) 121/4, Art. 115

¹²⁵ Id., Art. 123

¹²⁶ Id., Art. Art. 6(4).

- a) exclusive taxation in the country where profits originate, to *rebuild to the highest possible extent the link between taxation and where profits are made*;
- b) an immovable tax base, providing the incentive for countries to spontaneously approximate their corporate tax rates, to *eliminate the risk of profit shifting*;
- c) a multilateral sharing of information, which would be even more effective than a bilateral automatic exchange of information, to *strengthen to the highest possible extent the administrative cooperation between national tax authorities* and turn it into an “*administrative integration*”;
- d) a one-stop-shop for the fulfillment of all corporate tax obligations toward all countries to which a corporate taxpayer has tax liability, to simplify cross-border tax compliance.

However, to avoid tensions between national tax authorities, the “one-stop-shop” could be not a national tax authority operating on behalf of other national tax authorities as well, but a new European office made up of permanent representatives of national tax authorities, i.e. a new European One Stop Shop (EOSS), as argued elsewhere¹²⁷. In other terms, from the *procedural viewpoint*, the EU should ideally be regarded – by companies earning profits in more Member States and having tax liability toward more EU countries - as one single jurisdiction for tax residence purposes, which would make it possible to infer that the EOSS would lead to an “EU tax residence”. In the event of setting up of the EOSS, it should be for it – as a “one-stop-shop” - to collect tax returns and payments from all companies gaining profits in more Member States, and to retransmit all documentation and payments to each concerned national tax authority. Companies should be allowed – for simplification purposes – to use not different national tax returns forms, but *a single unified tax return*, to be sent to the EOSS and simultaneously accessible to all national tax authorities. In this single unified tax return, they should be able to report the profit arising in each Member State as well as the amount of corporate tax to be paid in each jurisdiction on a source-base; all information should be stored in a central database¹²⁸ immediately accessible to all concerned national tax authorities (multilateral sharing of information). This tax reporting solution would ultimately have the same role as the CbCR proposed by the Commission in the A.T.A.P¹²⁹. However, unlike this CbCR: it would not concern transfer pricing (which latter would no longer be an issue once either the CCCTB were introduced or one of the academic proposals were followed), and it would not be at risk

¹²⁷ L.Cerioni, *The European Union and Direct Taxation: A Solution for a Difficult Relationship*, Routledge, 2015, Ch. 5

¹²⁸ Just as in the CCCTB proposal: COM(2011) 121/4, cit., Art. 115.

¹²⁹ OECD Action Plan, Action 13, suggested a CbCR as regards the development of rules regarding transfer pricing documentation to enhance transparency for tax administration.

of being inapplicable as in cases of bilateral automatic exchanges of information (as national tax residence conflicts would no longer arise).

The suggestion for an EOSS - just as the DBCT, the “corporate tax 2.0” and the NCCTB suggestions - would imply going *beyond* the current international tax framework from both the substantive and the procedural viewpoint. In fact, ultimately, all these three academic suggestions would give up the national tax residence (as currently identified) as a connecting factor for a substantive tax jurisdiction¹³⁰ based on the worldwide taxation principle.

In particular, the NCCTB would contribute to overcoming the national tax residence together with the complementary suggestion for a tax on “residual profit” levied at EU level¹³¹, which would need to uniformly apply to companies resident in whatever Member State.

Obviously, in the design and application of a tax levied at EU level, even if limited to the “residual profits”, residence in one or in another Member State would not be a distinguishing factor. Apart from its being limited to “residual profits”, this tax would be a re-edition of the suggestion for a European Union Company Income Tax (EUCIT) which was envisaged ever since 2001¹³², and it would be consistent with the idea of considering the EU – for its application - as a single residence jurisdiction.

The EUCIT, which would imply the introduction of supranational rules relating not only to the tax base, but also to the tax rate (and would thus go beyond the CCCTB), was regarded as not realistic for the time being, due especially to the high political sensitivity of the corporate taxation area¹³³. Nonetheless, it was convincingly argued that the EUCIT could be conceived either as a scheme addressed to multinational companies and applying alongside national rules or as a more general scheme applicable to all companies, that it could provide the EU a new direct source of “own resources”, that it would facilitate the achievement of the action points set out by the OECD in the BEPS Action Plan and, lastly, that it would prevent Member States from using corporate income tax for tax competition amongst themselves¹³⁴.

Instead of a general EUCIT, an EU tax levied only on “residual profits” of companies – as suggested together with the NCCTB idea - could still provide the EU with a new “own resource”, and leave Member States with a degree of autonomy in

¹³⁰ Retro, 3.1., 3.2. and 3.4.

¹³¹ Retro, 3.3.

¹³² Commission Staff Working Paper, Company Taxation in the Internal Market, COM (2001), 1681, at 377

¹³³ B.Peeters, EUCIT: For How Much Longer Will Political Objections Outweigh the Advantages? EC Tax Review, 2015-3, 128-131, at 130

¹³⁴ Id., at 129

determining their own national tax rates on the “normal profits” (the immovable tax base resulting from the NCCTB cost-plus approach).

The idea for an EU tax on “residual profits” would certainly be – as regards its procedural application - compatible with the hypothesis of a EOSS.

Combined with an immovable tax base – created by either a sales-destination market or a cost-base - and with the exclusive taxing rights to source countries (to be identified either with the NCCTB approach or with the DBCT/ “corporate tax 2.0” approach), the EOSS and *multilateral* sharing of information would obviously manage to achieve the outcomes of intended by the Commission in terms of transparency and of fostering collaboration between national tax authorities.

This solution based on a EOSS would also be complementary to the CCCTB, to the extent that - in addition to avoiding the difficulties arising in the event of problems in locating the “place of effective management” of the parent company – it would imply the setting up of a multilateral sharing of information system. It would also make it easier the smooth functioning of the CCCTB, which would also be based on multilateral information sharing.

The multilateral sharing of information would turn the current phase of “administrative cooperation” between tax authorities of Member States into a day-to-day “administrative integration”, allowing a simultaneous access to information. Due to exclusive source taxation, and to the immobility of the tax base, it would make sense for national legislators to spontaneously converge toward each other in designing the rules governing the tax base and the tax rate. It would also become more convenient for each of them to have, within their jurisdiction, taxpayers earning profits in other EU jurisdictions rather than in third countries, because the multilateral sharing of information (within the EU) – due its being instantaneous - would be more effective than the automatic bilateral exchange of information (which latter, in prospective, could apply with third countries too).

Ultimately, the suggested solution would thus seem to be able to bring about a “*single fiscal market*”¹³⁵ for corporate taxation, and, in consequence, to achieve the revenue stabilization for each country and the level playing field that the Commission stated as necessary goals. It was submitted that – as regards the EU’s strategy focusing on fighting international tax avoidance –some partial harmonization is essential if the EU efforts are to succeed¹³⁶: the solution here proposed could, eventually, bring about the

¹³⁵ Definition used by C.HJI Panayi, *Advanced Issues in International and European Tax Law*, Bloomsbury, 2015, at 317

¹³⁶ *Id.*

same outcome, but it would do so through an *alternative route* created by administrative integration, stability of the tax base and bottom-up convergence.

6. Conclusions

The Commission's objectives to ensure taxation where profits are really generated, and to counter international tax avoidance, are ultimately shared by academic proposals for reform such as the DBCT, the "Corporate Tax 2.0" or the NCCTB. These proposals, however, suggest achieving these objectives by going *beyond* the current international tax law framework for corporate taxation, whereas the Commission (as well as the OECD) appears to stick to this framework, i.e. to the *same international tax law framework* in which distortions such as profit shifting have arisen. It follows, from the foregoing analysis, that these academic proposals would seem to be more consistent with the ultimate objectives.

The best achievement of these objectives would, therefore, require the quest for an optimal corporate tax system, that should no longer be based on the distinction between residents and non-residents, that should ensure an immobile tax base – so as to eliminate profit shifting phenomenon – and that should combine transparency and collaboration between tax authorities with simplification of compliance of tax obligations for companies having cross-border incomes.

Although a simplification of tax compliance through a one-stop-shop system and a new connecting factor for the tax base are common to the academic proposals and to the Commission's long-term objective of introducing a mandatory CCCTB, the academic proposals have been suggesting solutions that would deprive of their own purpose most of the shorter term initiatives proposed by the Commission both in the 2015 Action Plan and in the A.T.A.P.

The solution here suggested - whilst being complementary with the CCCTB in advancing the multilateral sharing of information - would aim at collecting the key inputs of the academic proposals in terms of immovability of the tax base, consistently with the stated intention of rebuilding the link between taxation and where the profits really originate.

Ultimately, there appear to be a key step that, at least at *conceptual level*, needs to be taken in the quest for an optimal corporate taxation system and for an effective fight against international tax avoidance: to definitively agree, at an academic and decision-

makers' level, on *whether companies' profits ultimately originate* where the business activity is carried on, as indicated by *costs* incurred (as in the NCCTB suggestion), *or* where the *market base* is located, if different (DBCT or "corporate tax 2.0" suggestions). In this regard - as any company would, as a minimum goal, aim at achieving stability of its profits - the greatest possible geographical immovability of the tax base should be the guiding criteria in a conceptual choice between a cost-base and a market-base. Once a connecting factor for exclusive source taxation capable of ensuring a *immovable* tax base were identified within the EU, the currently overriding concerns about preventing base erosion, profit shifting and double non-taxation would be overcome. Moreover, it would be in the mutual interest to achieve an "administrative integration" between tax authorities through a multilateral sharing of information - allowing each country immediate access to information about income arising or losses suffered in other countries - to be able to consider these information by applying its tax rates accordingly.

These outcomes, i.e. the stability of the tax base, and the "administrative integration" between national tax authorities – even if the long-term goal of introducing a mandatory CCCTB proved to be unachievable – would already be a cornerstone of an optimal corporate tax system and for an effective fight against international tax avoidance within the EU. To the extent that such outcomes - once achieved within the EU - may trigger a rethinking of the foundations of the international tax system outside the EU too, they could mark a key step in the quest for an optimal corporate tax system and for the most effective fight against international tax avoidance at wider international level as well.